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CITATIONS

804186—48

In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 175

ECCO HIGH FREQUENCY CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 15–24)[1] is a memorandum opinion and therefore not officially reported. The opinion of the Circuit Court of Appeals (R. 94–98) is reported in 167 F. 2d 583.

[1] The record references are to the Petitioner's Appendix and Proceedings in the Circuit Court of Appeals for the Second Circuit unless otherwise indicated. A duplicate certified copy of the Transcript of Record has been filed with the Clerk of this Court.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 27, 1948 (R. 99). The petition for a writ of certiorari was filed on July 23, 1948. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended.[2]

QUESTIONS PRESENTED

1. Whether the court below correctly held that there is substantial evidence to support the Tax Court's finding that $40,000, instead of $56,000 claimed by the taxpayer, was a reasonable salary for taxpayer's principal officer under Section 23 (a) of the Internal Revenue Code.

2. Whether the Circuit Court of Appeals properly exercised its power to review decisions of the Tax Court.

STATUTES INVOLVED

The statutes involved will be found in the Appendix, *infra*, pp. 10–12.

STATEMENT

The facts as found by the Tax Court (R. 16–20) are, in pertinent part, substantially as follows:

The business of the taxpayer-corporation is the manufacture of electrical high frequency indus-

[2] Effective September 1, 1948, 28 U. S. C. 1254 (1) becomes the jurisdictional basis for cases of this type. Pub. L. No. 773, 80th Cong., 2d sess.

trial heating equipment (R. 16). Emil R. Capita was its president, treasurer and only salaried officer during the years 1939, 1940 and 1941, and also acted as its sales engineer. Capita had gained knowledge of the business of manufacturing industrial high frequency equipment through his studies and especially through his employment as factory superintendent of the Lepel High Frequency Corporation, a concern engaged in manufacturing a high frequency converter used in automobile motors, by which he was employed between the years 1926 and 1937. In 1937, he decided that it would be advantageous for him to set up a business of his own. (R. 16, 17.) To aid his purpose, his uncle and aunt agreed to furnish capital to organize Ecco High Frequency Corporation, the taxpayer herein. To that end, they each subscribed $2,000 and received 50 shares of its capital stock, and entered into a written agreement with Capita on January 12, 1937, whereby they held the shares issued in their names for his "exclusive use and benefit." They also agreed that they would assign over their shares to Capita at any time upon his repayment to them of the subscription price of the shares; would make no other assignment of their shares except subject to the terms of the foregoing agreement; in the meantime would be entitled to receive all dividends paid on the shares; and that in the event of the liquidation of the corporation

before repayment of the subscription price, they would be entitled to receive $2,000 each while the balance of the liquidating dividends would be payable to Capita. (R. 16). Neither of the stockholders ever took any active part in the conduct of the business (R. 16), and Capita always regarded the business as his own and devoted all of his efforts to making it a success (R. 18). He designed all of the equipment manufactured by taxpayer, purchased all of its materials and sold all of its finished products. Most of the sales resulted from his personal contacts. As sales engineer of the corporation he secured contracts for particular types of equipment, supervised the manufacture, and saw that the equipment was properly installed and capable of satisfactorily functioning. (R. 17.)

It was the custom of the trade to pay commissions of 40% on sales of high frequency heating equipment made within the City of New York and slightly more on sales made outside of that territory (R. 18).[3]

The following table shows the taxpayer's gross sales (less returns and allowances), officers' salaries, net income, federal tax, and dividends paid, for the years 1937–1941, inclusive, as re-

[3] There was also evidence, however, that almost half of this commission was frequently in turn paid by the sales engineer to agents who secured the prospective purchasers, even though the sales engineer closed the sales himself (R. 90).

ported in its income tax returns for the respective years (R. 18):

Year	Gross sales less returns and allowances	Officers' salaries [1]	Net income	Federal tax	Dividends paid
1937	$16,926.75	(a) $3,835.00	$358.09	$51.78	None
1938	21,224.87	(b) 2,467.00	667.89	83.45	None
1939	35,581.19	(c) 7,040.00	849.57	105.20	$240.00
1940	69,489.12	(c) 20,840.00	2,940.15	461.35	240.00
1941	222,346.65	(c) 56,000.00	41,274.25	20,779.45	None

[1] Of the 1937 and 1938 salaries, the amounts of $2,400 and $427, respectively, were paid to Theo Bruning, who served as president of the company until his death in the latter part of 1938. The balance of the salaries for those years, and all of the 1939, 1940 and 1941 salaries were paid to Capita. (R. 18.)

At a meeting of the taxpayer's stockholders held on December 28, 1939, it was agreed that Capita should receive for that year as compensation for his services commissions of 15% of its gross sales. His compensation for 1940 was raised to 30% of gross sales at a stockholders' meeting held December 16, 1940. The same percentage of gross sales, 30%, was voted to him by the directors at a meeting held December 16, 1941, with the provision, however, that his total compensation should not exceed $56,000 for that year. The taxpayer reported this $56,000 in its tax return for 1941 as compensation for officers, but the Commissioner allowed only $25,000 and disallowed the balance, $31,000, as being unreasonable (R. 19). The Tax Court found $40,000 to be a reasonable amount for Capita to receive for his services in 1941 (R. 23–24). The Circuit Court of

Appeals affirmed the decision of the Tax Court (R. 94–98).

ARGUMENT

1. The Tax Court acted well within the power granted it when it found that the amount to be allowed as reasonable compensation was somewhere between the amount claimed by the taxpayer and that allowed by the Commissioner. But it is not the function of an appellate court to make such a determination. The facts set out in the statement, *supra,* and the opinion of the Circuit Court of Appeals (R. 94–98) suffice to show that the ultimate finding of the Tax Court was supported by substantial evidence. We see no justification for further burdening this Court with a discussion of this issue.[4]

2. The taxpayer argues that the scope of review by the Circuit Court of Appeals has been enlarged by the Administrative Procedure Act (Pet. 14–15). If it is assumed *arguendo* that that Act applies to the Tax Court, as the taxpayer urges, the Circuit Court of Appeals was correct in this case, since Section 10 (e) (B) thereof (Appendix, *infra,* p. 12) authorizes the reviewing court to

[4] The petitioner's contention that the tax is confiscatory (Pet. 16–17) is all but frivolous. To reach that result, it deducts legal fees in this proceeding paid up to December 31, 1947, and interest paid to July 22, 1948, in a case involving only the year 1941 (Pet. 18). Moreover, even if the petitioner paid $56,000 to Capita beyond recall, instead of the $40,000 allowable, the Commissioner cannot be estopped by the taxpayer's bad judgment.

reverse the findings and conclusions of an "agency", *inter alia,* when they are unsupported by substantial evidence. And under Section 1141 (c) of the Internal Revenue Code (Appendix, *infra,* p. 11), authorizing a reviewing court to reverse a decision of the Tax Court if it is "not in accordance with law," the "substantial evidence" rule has consistently been employed as the standard for review of factual findings of the Tax Court, both before and since the decision in *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231. See, for example, *Elmhurst Cemetery Co.* v. *Commissioner,* 300 U. S. 37; *Wilmington Co.* v. *Helvering,* 316 U. S. 164; *Commissioner* v. *Scottish American Co.,* 323 U. S. 119; *Boehm* v. *Commissioner,* 326 U. S. 287, rehearing denied, 326 U. S. 811. Thus, the Court of Appeals applied the correct standard of appellate review under both statutes. Cf. *Credit Bureau of Greater N. Y.* v. *Commissioner,* 162 F. 2d 7, 9 (C. C. A. 2d); *Anderson* v. *Commissioner,* 164 F. 2d 870, 874 (C. C. A. 7th). Consequently, in this case there is no necessity for this Court to consider whether the Administrative Procedure Act applies to the Tax Court, as the dictum in *Lincoln Electric Co.* v. *Commissioner,* 162 F. 2d 379, 382 (C. C. A. 6th), suggests (Pet. 14). Indeed, this Court has quite recently denied petitions for certiorari in which arguments identical with that here made were advanced.

Anthony P. Miller, Inc. v. *Commissioner,* 164 F. 2d 268 (C. C. A. 3d), certiorari denied, 333 U. S. 861; *Glenshaw Glass Co.* v. *Commissioner,* decided October 15, 1946 (1946 P-H T. C. Memorandum Decisions, par. 46,245), affirmed *per curiam,* October 21, 1947 (C. C. A. 3d) (1947 C. C. H., par. 9407), certiorari denied, 333 U. S. 842.

3. The taxpayer also argues that the recent amendment of Section 1141 (a) of the Internal Revenue Code (Appendix, *infra,* p. 10) by Section 36 of the Act of June 25, 1948, Pub. L. No. 773, 80th Cong., 2d Sess., broadens the scope of review by the court below in the instant case (Pet. 15–16). Since the effective date of the amendment is September 1, 1948, as provided in Section 38 of the Act, it could not have applied in the instant case. However, even if it were effective, it would not alter the result in this case unless it could be said that the decision of the Tax Court was "clearly erroneous". Rules of Civil Procedure for the District Courts, Rule 52 (a), as amended December 27, 1946. That this is not true is evidenced by the ruling of the court below that the decision of the Tax Court, fixing the reasonable value of Capita's services at $40,000, "cannot be regarded as arbitrary" (R. 97).

CONCLUSION

The decision of the court below is correct and there is no conflict of decisions. The case depends upon its particular facts and is not of general importance. The petition for a writ of certiorari should be denied.

Respectfully submitted.

PHILIP B. PERLMAN,
Solicitor General.

THERON LAMAR CAUDLE,
Assistant Attorney General.

GEORGE A. STINSON,
ELLIS N. SLACK,
MORTON K. ROTHSCHILD,
Special Assistants to the Attorney General.

SEPTEMBER 1948.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In general.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *

* * * * *

(26 U. S. C. 23.)

SEC. 1141. COURTS OF REVIEW.

(a)[1] *Jurisdiction.*—The Circuit Court of Appeals and the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 239 of the Judicial Code, as amended, 43 Stat. 938 (U. S. C. Title 28, Sec. 346); and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 240 of the Judi-

[1] This section has been amended by Section 36 of the Act of June 25, 1948, Pub. L. No. 773, 80th Cong., 2d Sess. The effective date of the amendment is September 1, 1948, as provided in Section 38 of the Act of June 25, 1948.

cial Code, as amended, 43 Stat. 938 (U. S. C., Title 28, Sec. 347).

* * * * *

(c) *Powers.*—

(1) *To affirm, modify, or reverse.*—Upon such review, such courts shall have power to affirm or, if the decision of the Tax Court is not in accordance with law, to modify or to reverse the decision of the Tax Court, with or without remanding the case for a rehearing, as justice may require.

* * * * *

(26 U. S. C. 1141.)

Administrative Procedure Act, c. 324, 60 Stat. 237:

DEFINITIONS

SEC. 2. As used in this Act—

(a) *Agency.*—"Agency" means each authority (whether or not written or subject to review by another agency) of the Government of the United States other than Congress, the courts, or the governments of the possessions, Territories, or the District of Columbia. Nothing in this Act shall be construed to repeal delegations of authority as provided by law. * * *

* * * * *

(5 U. S. C. 1001.)

JUDICIAL REVIEW

SEC. 10. Except so far as (1) statutes preclude judicial review or (2) agency action is by law committed to agency discretion—

* * * * *

(e) *Scope of review.*—So far as necessary to decision and where presented the

reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of any agency action. It shall (A) compel agency action unlawfully withheld or unreasonably delayed; and (B) hold unlawful and set aside agency action, findings, and conclusions found to be (1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; (2) contrary to constitutional right, power, privilege, or immunity; (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (4) without observance of procedure required by law; (5) unsupported by substantial evidence in any case subject to the requirements of sections 7 and 8 or otherwise reviewed on the record of an agency hearing provided by statute; or (6) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court. In making the foregoing determinations the court shall review the whole record or such portions thereof as may be cited by any party, and due account shall be taken of the rule of prejudicial error.

(5 U. S. C. 1009).

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